

# Co-investment framework under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 – a long-awaited development

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## Introduction

The Securities and Exchange Board of India (SEBI) on 8 September 2025, in a much-awaited move has notified an amendment (Amendment) to the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (AIF Regulations) followed by the 'Framework for AIFs to make co-investment within the AIF structure under SEBI (Alternative Investment Funds) Regulations, 2012' notified under its circular dated 9 September 2025, ("Framework" which read together with the Amendments shall be called the "Co-Investment Framework") and has formally introduced a framework for a co-investment (CIV) scheme to be launched by Category I AIFs (Cat I AIFs) and Category II AIFs (Cat II AIFs) for allowing participation of 'accredited investors' (AIs) in portfolio investments in unlisted securities made by the Cat I AIFs and Cat II AIFs. The Co-investment Framework has been issued pursuant to the 'consultation paper on providing flexibility to AIFs to offer Co-Investment opportunities to investors within the AIF structure under SEBI (Alternative Investment Funds) Regulations, 2012' that was issued by SEBI on May 09, 2025 (Consultation Paper).

## The following broad enabling factors have been prescribed under the Co-investment Framework

- (i) Ability to launch CIV Schemes: Only Cat I AIFs and Cat II AIFs can launch CIV schemes and the Amendments clearly specify that angel funds set up under the AIF Regulations cannot launch CIV schemes.
- (ii) Participation: Co-investment opportunities in unlisted securities may only be offered to the AIs of a Cat I AIF / Cat II AIF through a CIV scheme launched by the Cat I AIF / Cat II AIF in addition to the already existing co-investment portfolio manager route (CPMS) under the Securities and Exchange Board of India (Portfolio Managers) Regulations, 2020 (PMS Regulations).
- (iii) CIV Scheme for each co-investment: Each co-investment opportunity (pertaining to a particular portfolio company) can be offered to AIs of the relevant Cat I AIF / Cat II AIF via launch of a separate CIV Scheme.
- (iv) Documentation with SEBI: From a process perspective, in order to launch a CIV scheme, the manager of Cat I AIF / Cat II AIF, will be required to file a shelf memorandum with SEBI through a merchant banker along with a fee of INR 1,00,000 prior to offering the co-investment opportunity to its investors. The Co-investment Framework provides for a template of the shelf memorandum which sets out the key terms, governance structure, etc. as applicable to co-investments.
- (v) Separate accounts: Each CIV scheme must have a separate bank account and demat account, and assets of each CIV scheme must be ringfenced from other schemes.

- (vi) Terms of co-investments: The terms of co-investment in an investee company by a CIV scheme cannot be more favourable than the terms offered to the AIF. Further, the timings of exit must also be identical for both the CIV scheme as well as the AIF. The investment manager should also ensure that:
  - a. The rights of investors in investments and distribution through the CIV scheme shall be pro-rata to their capital contribution to the CIV scheme, except when any additional return equivalent amount is shared with the manager, sponsor or employees / directors / partners of the manager of AIF.
  - b. Co-investment expenses shall be shared proportionately between the AIF and CIV scheme in the ratio of their respective investments.
- (vii) Investments into CIV schemes: The co-investments made by an investor in an investee company across CIV schemes must not exceed three times of the contribution made by the investor in the total investment made to said investee company through the AIF (to which the CIV schemes are affiliated). However, this restriction shall not apply to:
  - a. Multilateral or Bilateral Development Financial Institutions;
  - b. State Industrial Development Corporations;
  - c. Entities established or owned or controlled by the Central Government or a State Government or the Government of a foreign country, including Central Banks and Sovereign Wealth Funds

To illustrate the investment cap applicable to each investor, consider an investor who has committed a capital amount of INR 100 crore to an AIF with a total corpus of INR 1,000 crore. Suppose the AIF initiates a CIV scheme specifically designed to enable co-investments alongside the AIF in a target company, here referred to as 'Company X.' If the AIF's direct investment in Company X amounts to INR 50 crore, then, ceteris paribus, the investor's pro-rata share of the AIF's investment in Company X being INR 5 crore, in accordance with the Co-Investment Framework, the maximum amount that the investor may additionally invest via the CIV scheme in Company X shall be capped at INR 15 crore.

It is to be noted that this 3x investment cap has presently only been prescribed for co-investment through CIV schemes. That is, the co-investment under the CPMS route should be outside the purview of the aforementioned investment cap.

- (viii) Investments by CIV schemes: CIV schemes are barred from making any investment which:
  - a. Leads to creation of interest / exposure by investor indirectly in an investee company, when such interest / exposure is not permitted directly in such investee company;
  - b. Reduces regulatory disclosure obligations required for investment being made directly; or
  - c. Leads to indirect investment in an investee company where the investee company cannot accept investment from such investor directly.
- (ix) Advisory services by the manager of the AIF: The AIF Regulations have been updated to include CIV schemes as a dispensation to the general prohibition on managers from providing advisory services. That is, Regulation 20(15) of the AIF Regulations which earlier allowed a manager to an AIF to provide advisory services in respect of investment in investee companies of the AIF, only to clients of the co-investment portfolio manager under the Securities and Exchange Board of India (Portfolio Managers) Regulations, 2020, has now been updated to also allow the manager of an AIF to offer advisory services to the investors of the CIV scheme.
- (x) Usage of leverage: CIV schemes are prohibited from borrowing directly or indirectly, or engaging in leverage.
- (xi) Winding up of co-investment scheme: The CIV scheme should be wound up on the exit of the co-investments from the relevant portfolio company.
- (xii) Restriction on investments in units of other AIFs: CIV schemes have been prohibited from investing in units of other AIFs.
- (xiii) Treatment of excused / excluded and defaulting contributors: Contributors excused / excluded or defaulting in their capital contribution for investment in an investee company by the primary scheme of the AIF are not permitted to co-invest in the said investee company.

- (xiv) SFA empowered to formulate further rules: Furthermore, for additional regulatory oversight, the Co-Investment Framework provides that implementation standards may be formulated by the Standard Setting Forum of AIF, in consultation with SEBI.

## Analysis and Conclusion

Below are the key observations in respect of the Co-investment Framework:

- (i) Scope of participation: Currently, only investors belonging to a particular scheme of the AIF that launches the CIV scheme are allowed to participate in the CIV scheme. Ideally, investors across all schemes of the relevant Cat I AIFs and Cat II AIFs should be allowed to co-invest in the CIV scheme launched by the manager of such AIFs, enhancing flexibility and access to opportunities to co-invest. This is an added route allowing investors of AIFs to make co-investments in investee companies similar to the right already available under the CPMS route.
- (ii) Regulatory guardrails: The prohibition on investors from utilizing CIV schemes to do acts indirectly that could not be undertaken directly is an expected move by the regulator and is aligned with the general framework under the CPMS regime. This would also ensure that only those investors who are able to directly participate in an investee company will be permitted to invest through the CIV scheme. As an illustration, note the following:
  - a. In the absence of such a restriction is that companies in distress would have indirectly taken investments by promoters via CIV schemes.
  - b. If an investee company operates in any restricted sector, then CIV may not be able to accept contribution from foreign investors. Therefore, foreign investors who are otherwise able to make investments via an 'Indian owned and controlled' AIF will not be able to make investments via the CIV scheme given that paragraph 2.6 states, "where the investee company cannot receive investments from such investor directly."
  - c. Similarly, the choice of investments for foreign investors will be limited to what is directly usable by such investors. That is, CIV schemes having foreign investors may only be able to make investments in such securities as are permissible for foreign investors.
- (iii) Scope of investments by CIV schemes: CIV schemes are currently only permitted to invest in unlisted securities. Expanding the scope of investments to also include listed securities may be considered, rather than limiting CIVs to unlisted securities only, given that Cat II AIFs are also allowed to invest in listed securities such as listed debt (which is not publicly traded but traded on a wholesale market)
- (iv) Feeder fund investors: The Co-investment Framework does not expressly clarify whether investors of a feeder fund that invests into the AIF will also be allowed to co-invest via the CIV scheme of the AIF. While logically this should be the case given that investors of a feeder fund are indeed investors of the AIF on a look-through basis, express language in this regard would have been helpful.
- (v) Timing of exit: There are many instances where co-investors have the capacity to hold an investment for a longer period (as AIFs have a definitive term and need to exit within that period). In other cases, the AIF and co-investors operate as a block (for rights under the portfolio level agreements) and therefore, are already tied together. There are also instances where a portfolio company goes through several rounds of fund raise and therefore, it may not always be possible to time the exit of the AIF and the co-investor together.
- (vi) Filing of shelf memorandum: As the Framework does not prescribe a specific timeline for the filing of the shelf memorandum, it is presently unclear whether the memorandum is to be filed prior to the co-investment opportunity being offered to the investors or at the time of filing the **primary AIF's PPM** with SEBI. We note that the latter option was explored in the Consultation Paper, however, is not accounted for in the Framework. Similarly, there is currently no clarity on whether a specific approval of SEBI will be required in respect of each CIV scheme or whether a green channel route of deemed approval of the shelf memorandum within 30 days of filing the PPM with SEBI, (as envisaged under the Consultation Paper and which has not been carried over under the Framework) will be available for AIFs.
- (vii) Participants to carry: In a welcome move, the Framework expressly expands the universe of eligible additional return participants to include employees/directors/partners of the manager of AIF which is an expansion over the relatively narrow universe of additional return participants under the SEBI

circular on 'Pro-rata and pari-passu rights of investors of AIFs' dated December 13, 2024 (SEBI Pro-Rata Circular) which limits the sharing of additional return to the sponsor and manager. Here, it would be helpful to have a clarification from SEBI to harmonize the two SEBI circulars which would provide much needed comfort to the industry participants. Additionally, like the SEBI Pro-Rata Circular, the Framework continues to exclude other participants such as strategic advisors, anchor investors, and members of the investment committee from the universe of eligible additional return participants.

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